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Before the
Federal Communications Commission
Washington, DC 20554

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In the Matter	)	
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GTE CORP.	)	
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Transferor,	)	
	)	
and	)	**CC Docket No. 98-184**
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BELL ATLANTIC CORP.	)	
	)	
Transferee,	)	
	)	
For Consent to Transfer of Control	)	

OPPOSITION OF AT&T CORP. TO APPLICANTS' PROPOSAL REGARDING GTE'S INTERLATA OPERATIONS

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Pursuant to the Public Notice issued by the Commission on January 31, 2000, AT&T Corp. ("AT&T") respectfully submits this Opposition to the proposal of Bell Atlantic Corp. ("Bell Atlantic") and GTE Corp. ("GTE") (collectively "Applicants") to transfer ownership and control of GTE's interLATA Internet backbone facilities to Bell Atlantic. *See* Supplemental Filing of Bell Atlantic and GTE, CC Docket No. 98-184, Jan. 27, 2000 ("Supp. Filing").

INTRODUCTION AND SUMMARY

Applicants' Supplemental Filing is the most recent in a seemingly unending series of proposals in which Bell Atlantic and GTE seek devices that would enable Bell Atlantic to own and control GTE's interLATA Internet facilities before it obtains the authorizations required by Section 271 of the Communications Act of 1934 ("the Act"). In their initial filing, Applicants simply pretended that there was an Internet "exception" to Section 271 and, accordingly, did not even address the issue. *See* Public Interest Statement of Bell Atlantic and GTE (Oct. 2, 1998) ("BA-GTE Public Interest Statement"). In their reply comments, while still maintaining that Section 271 did not apply to GTE's Internet backbone business, they asserted that the Commission could (and should) remedy any such difficulty by creating a single, world-wide data LATA. Joint Reply of Bell Atlantic and GTE to Petitions to Deny and Comments at 15-17 (Dec. 23, 1998) ("BA-GTE Reply Comments").[1]

Ultimately recognizing that the Commission had no such authority, Applicants then offered a flurry of other proposals. On November 9, 1999, Applicants filed an *ex parte* stating that they could eliminate any Section 271 issue by transferring GTE's Internet assets into a blind trust. *See Ex Parte* Letter from Nancy Victory to Magalie Salas (Nov. 9, 1999). That particular trial balloon, however, was short-lived and soon replaced. Two weeks later, Applicants filed yet another *ex parte* in which they abandoned the blind trust and instead outlined two other possible arrangements that they claimed would eliminate any Section 271 issues: a sale/contingent repurchase agreement and a tracking stock for GTE's Internet facilities. *See generally Ex Parte* Letter from Steven Bradbury to Magalie Salas (Nov. 24, 1999). Those likewise were quickly withdrawn.

The new proposal *du jour* further confirms the obvious. Bell Atlantic and GTE are unwilling to do what Section 271 plainly requires: delay closing the merger until Bell Atlantic obtains the necessary Section 271 authorizations or surrender ownership and control of all of

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[1] Applicants subsequently refined this proposal in a February 24, 1999 *ex parte* in which they formally asked the Commission for "the establishment of a single LATA for [GTE] Internetworking's existing businesses" that would take effect "once Bell Atlantic obtains long distance authority covering at least one-quarter of its lines" and that would last "for a period of (continued . . .)

GTE's interLATA businesses prior to any merger. Complying with this standard would not involve any of the complexities that have accompanied each of their Rube Goldberg submissions. If Bell Atlantic is unwilling to first obtain the necessary Section 271 authorizations, it would require a straightforward divestiture.[2] In the absence of such a divestiture, the merger is precluded as a matter of law and, if not disapproved by the Commission, would be undone by the Court of Appeals.

Like all the schemes that came before it, the current proposal asks the Commission to elevate the most superficial aspects of form over substance and to ignore the obvious economic reality of the transaction the Applicants put forward.[3] Under Applicants' theory, the analysis begins and ends with the fact that their initial percentage of voting stock would be limited to 10 percent. But Section 3(1) of the Act, which defines "affiliate" for these purposes, forecloses any such approach. It prohibits not only "direct" but "indirect" ownership and control, and not only equity interests that exceed 10 percent but any "equivalent" of such interests. It is written broadly precisely to preclude the types of fictions on which Applicants' proposal rests.

(. . . continued)
two years after closing (unless extended for good cause)." *Ex Parte* Letter from Steven Bradbury and Michael Glover to Thomas Krattenmaker, at 1 (Feb. 24, 1999).

[2] This requirement is not subject to Commission waiver. *See* 47 U.S.C. § 160(d).

[3] Instead of expending valuable agency resources considering scheme after scheme to circumvent Section 271, the Commission could better expend its energy in efforts to ensure that GTE and Bell Atlantic *comply* with Section 251(c) of the Act. The Commission might also wish to examine GTE's compliance with other legal requirements, for example, by resuming the long-delayed audits of GTE's continuing property records ("CPR"). Such audits, as were conducted during the early and mid-1990s (spurred by NARUC resolutions seeking Federal/State joint audits of GTE's operating companies), revealed that GTE's compliance with the Commission's accounting rules is sorely deficient. *See GTE Telephone Operating Companies*, 13 FCC Rcd 9179 (1998); *GTE Telephone Operating Companies*, 9 FCC Rcd. 2594 (1994). Yet GTE was inexplicably omitted from the more detailed CPR audits subsequently conducted on the BOCs.

Part I of this Opposition shows that, under the current proposal, a merged Bell Atlantic/GTE (hereinafter "Bell Atlantic") would "own" at least 80 percent of the total assets of GTE's interLATA Internet business from its first days as a putatively separate company. Because its "option" to claim 80 percent of the shares of "DataCo" will certainly be exercised, and because the straightjacket of proposed "Investor Protection Mechanisms" makes it unlikely that earnings will be paid to shareholders before the option is exercised, the shares being sold to the public are likely to be valued by the market at no more than 20 percent of the value of the new firm (leaving a minimum of 80 percent for Bell Atlantic). Applicants nonetheless claim that Commission precedent, and precedent under the AT&T Consent Decree (the "MFJ"), support the notion that the Commission can ignore these economic realities and find Bell Atlantic to be only a 10 percent owner. Those precedents, not surprisingly, say no such thing. Applicants can maintain otherwise only by citing cases for propositions opposite to what those cases actually hold, omitting key language from the sentences they quote, relying (without saying so) on old rules that have been superseded by new rules that foreclose their approach, and citing the Cable Bureau's summary of their own comments as "Commission precedent."

Part II of this Opposition shows that Bell Atlantic's decision to retain numerous rights in DataCo – including the largest single voting interest, board representation, the "option" to re-acquire the company, veto powers, and a host of other arrangements – would permit it to retain "control" of DataCo and its interLATA facilities, equally in plain violation of Section 271. As with Section 3(1)'s broad view of "own," the Commission and courts have rejected formal and artificial tests of control, like the one Applicants advocate here (which largely consists of a simplistic "count the shares" approach), in favor of consideration of the cumulative effect of relevant mechanisms by which an entity can exert control. Under that approach, it is clear that the myriad and substantial corporate powers in DataCo that Bell Atlantic has appropriated place it in the preeminent position to control DataCo. Applicants' proposal thereby ensures that, despite supposed public ownership, DataCo will be operated according to Bell Atlantic's interests and sterilized from truly independent or divergent influence, so that Bell Atlantic may seamlessly reacquire it, just as though it had never left the corporate umbrella. In asserting a contrary conclusion, Applicants once again misstate prior Commission rulings, claiming that it has routinely approved similarly broad rights without finding control. In fact, the Commission's decisions are clear that its approval of any one of these types of control mechanisms was made only after findings that other possible means for control were absent. The Commission has never endorsed the unprecedented combination of powers that would be possessed by Bell Atlantic here.

Further, as shown in Part III, the proposed "spin-off" would also violate the purpose of Section 271 – to prevent monopoly leveraging and discrimination in the interLATA market and to give Bell Operating Companies ("BOCs") the incentive to open up their local markets to competition. *See Paulsen v. IRS*, 469 U.S. 131, 142 (1985) (courts will not "exalt artifice above reality" where it would "deprive the statutory provision in question of all serious purpose"). Because Bell Atlantic would own and control DataCo, Bell Atlantic would have both the incentive and ability to discriminate in favor of DataCo. Indeed, Applicants effectively concede this point. Applicants argue that, without access to Bell Atlantic's customers in major urban areas, GTE's Internet business (and hence, DataCo) might not succeed. BA-GTE Public Interest Statement at 3, 16. But GTE already has "access" to customers in all these regions; its backbone network extends throughout the Eastern United States. Thus, Applicants must believe that Bell Atlantic has the ability to steer its customers onto GTE's Internet facilities in ways that GTE, unaffiliated with Bell Atlantic's monopoly, could not. And because Applicants have taken steps to capture all of the economic benefits of discriminating in favor of DataCo, they will have the incentive to do so as well.

In this regard, it is striking that, in contrast to their proposal for data services, Applicants now acknowledge that they must and will "exit . . . *voice* long distance service within Bell Atlantic's non-271-approved states" "[b]efore the merger closes." Supp. Filing at 29 (emphasis added). If their proposal for interLATA data services were permissible, however, it would be equally valid for interLATA voice services. Thus, although they have formally abandoned the untenable suggestion that interLATA data services are not subject to Section 271, they appear to continue to believe that data services somehow stand on a different, far more permissive footing. That is not so. The statutory definition of "affiliate" does not and cannot turn on what services the affiliate provides. If Applicants' proposal here were lawful, it would be equally lawful for a BOC to create the same relationship with an interexchange carrier providing voice services. As shown in the remainder of this Opposition, however, it would be unlawful in both contexts.

Finally, although the facts that Applicants have set forth themselves sufficiently establish the transaction's unlawfulness, it is also the case that other information on which Applicants have thus far been silent could reveal additional grounds requiring rejection. For example, Applicants have not provided the charter and by-laws that would govern DataCo, which could contain restrictions beyond those described by Applicants. *Accord* Fletcher's Cyclopedia Corporations § 5083 (1995 rev. ed.) ("The relationship between the corporation and its shareholders is to a large degree contractual in nature, the terms of which may be set out in the corporation's articles of incorporation, bylaws or share certificates."). Likewise, no back-up is provided for the so-called "commercially reasonable" contracts between DataCo and Bell Atlantic. Nor have Applicants explained what will be omitted from their transfer of "substantially" (Supp. Filing at 32) all of GTE's nationwide data business to DataCo.

I. BELL ATLANTIC WOULD OWN DATACO IN VIOLATION OF SECTION 271

Contrary to Applicants' claims, the proposed transaction would allow Bell Atlantic to acquire an ownership interest in DataCo substantially greater than the 10 percent maximum permitted by Sections 271 and 3(1) of the Act. In fact, even after the purported "divestiture" Bell Atlantic would "own" at least 80 percent of DataCo. The Class B shares Bell Atlantic would acquire, while only 10 percent of the total number of shares in DataCo, nonetheless would entitle Bell Atlantic to 80 percent of DataCo's economic value.

To begin with, it is a certainty that the "option" contained within the Class B shares will be exercised within five years, and that the holder of those shares will therefore obtain 80 percent of DataCo's shares. In fact, in a prior *ex parte* letter to the Commission on this issue, Applicants conceded that "DataCo stock will trade based upon [Bell Atlantic's] expected level of ownership assuming conversion of [the] B shares." *Ex Parte* Letter from Patricia Koch to Magalie Roman Salas, Att. at 2 (Dec. 24, 1999). Applicants' attempt to back away from this admission – *i.e.*, their newly minted claim (p. 42) that Bell Atlantic might choose not to exercise its option "for economic or business reasons" – should be rejected out of hand. The "option" costs nothing to exercise. Therefore, so long as DataCo has any value at all, it will be economically advantageous for Bell Atlantic to exercise its option. Indeed, even if Bell Atlantic chose not to obtain the necessary Section 271 authorizations within the five-year period its proposal would establish, Applicants acknowledge (p. 33) that Bell Atlantic would have the right to sell its shares to an entity not bound by Section 271 and "that purchaser would be free to convert those Class B shares immediately."

But in all events, Bell Atlantic would certainly be in a position to exercise the option itself. Contrary to its suggestion (p. 42) that it may not receive the necessary interLATA authorizations in five years – more than 9 years after passage of the Act – such authorizations are entirely within Bell Atlantic's control. The Act "places in each BOC's hands the power to determine if and when it will enter the long distance market," because "it is the BOC's willingness to open its local telecommunications markets to competition pursuant to the requirements of the Act that will determine Section 271 approval."[4] The only reason more BOCs are not in the long-distance market today is that they largely chose to challenge the Act rather than comply with it or decided that they prefer the monopoly returns from a closed local market in preference to the competitive returns available from the interLATA long distance market. No BOC that is willing to comply with Section 271's requirements can or will be denied interLATA authorization.

Indeed, the Applicants effectively acknowledge that there is no doubt that Bell Atlantic will exercise its option: they ask the Commission to find that the principal public interest benefit of the merger is that it will "ultimate[ly]" produce "the combination of GTE's [Internetworking business] with Bell Atlantic's . . . concentrated and business-rich customer base," and state that

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[4] *See* Memorandum Op. and Order, *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in Michigan*, 12 FCC Rcd. 20543, ¶ 23 (1997); *see also* Separate Statement of Chairman Hundt ("[a]ny BOC that wishes to take the steps necessary to follow the roadmap will have the opportunity to enter the long distance market"); Memorandum Op. and Order, *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Services in the State of New York*, CC Docket No. 295, ¶ 15 (Dec. 22, 1999) ("Our action today clearly demonstrates that when a BOC takes the steps required to open its local markets to full competition, the company will be rewarded with section 271 authority to enter the long distance market"); Memorandum Op. and Order, *Application of BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in South Carolina*, 13 FCC Rcd. 539

(continued . . .)

their proposal here is an effort to preserve their ability to achieve that "benefit[]." Supp. Filing at 3-4. That finding could only be made if the Commission first found – as is clearly the case – that Bell Atlantic itself would in fact convert its Class B shares.

Accordingly, given that it is a certainty that the Class B shareholder (regardless of whether it is in fact Bell Atlantic or instead a subsequent purchaser) will within five years convert those shares and obtain 80 percent of DataCo's shares, the complementary market value of the Class A shares being sold to the public can be no more than 20 percent of the value of DataCo, plus any earnings those shares can receive during the time before the "option" is exercised. And while Applicants assert (p. 36) that the Class A shareholders will get 90 percent of "economic returns" earned during this interim period, nothing could be further from the truth.

To the contrary, Applicants' so-called "Investor Protection Mechanisms" are designed to protect Bell Atlantic from having to pay any of DataCo's "economic returns" to the Class A shareholders. The "Investor Protection Mechanisms" deprive the Class A shareholders of the principal means by which they might tap into DataCo's "economic returns." Without Bell Atlantic's consent, the so-called "90 percent owners" of DataCo cannot sell any asset, issue shares or other securities, or authorize new stock. *See* Supp. Filing, Sched. A. Bell Atlantic's consent is also required for the issuance of "extraordinary" dividends. *Id.* Of course, it is extremely unlikely that Bell Atlantic would consent to any of these actions because they would transfer sums from Bell Atlantic to the Class A shareholders.

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(1997) (Separate Statement of Commissioner Powell) ("the seeds of section 271 success [are] in the hands of the BOC applicants").

Thus, the only conceivable mechanism by which Class A shareholders will be able to share in DataCo's "economic returns" is *ordinary* dividends. But the prospect of any such dividends is remote. DataCo has no history of paying dividends (and therefore there is no shareholder expectation of dividends), and there is apparently no requirement in either the Class A shares or in DataCo's charter that a dividend be paid. Indeed, in light of these facts, any dividend that DataCo might issue could be considered "extraordinary" and thus subject to Bell Atlantic's veto.

In short, because there is no chance that the Bell Atlantic (or a subsequent purchaser) will not exercise the "option" that would allow it to obtain at no cost 80 percent of DataCo's shares, and because prior to that time Class A shareholders are unlikely to have any effective rights to any "economic returns" generated by DataCo, the economic value of the Class A shares represents, at most, 20 percent of the market value of the company. Indeed, this value is undoubtedly overstated because the market will assess the Class A shares at *less* than 20 percent of the total value of the company. Because of the strong likelihood that Bell Atlantic will control DataCo for the foreseeable future and prevent DataCo from issuing dividends, the market is likely to value the Class A shares at much less than 20 percent of the value of the company. *See* F. HODGE O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS §§ 2.15, 4.01, 4.02 (1975). By contrast, Bell Atlantic's 80 percent interest would trade at a premium that reflects its total control of DataCo. *See id. Accord*, *Pope & Talbot, Inc. v. IRS*, 162 F.3d 1236, 1241 (9th Cir. 1999); *Foltz v. US News & World Report, Inc.*, 865 F.2d 364, 370-72 (D.C. Cir. 1989).[5]

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[5] Bell Atlantic's Class B shares have an additional attribute that also serves to make them more valuable on a *pro rata* basis than the Class A shares. One of the so-called "Investor Safeguards" is that "[i]f at the time [Bell Atlantic] converts its shares, it owns shares at least equal to 70% of DataCo, it shall have the right to purchase from DataCo, at market, a number of shares that will increase its ownership to 80%." Supp. Filing, Sched. A. This means that Applicants have (continued . . .)

These are the economic realities of this sham transaction. They are the realities that would govern the conduct and expectations of the market and of DataCo's investors, officers, directors, managers, and employees. But although none of those market participants could ignore these realities, Applicants urge the Commission to do so. According to Applicants, as a matter of law, only "current equity," and not "future interests," may be taken into account under Section 3(1). Thus, Applicants assert, regardless of the true economic value of the Class B shares, Bell Atlantic will have only 10 percent of the outstanding shares in DataCo and therefore will not "own" DataCo within the meaning of Section 3(1). This fiction is foreclosed by the text and purpose of Section 3(1), as well as the relevant Commission and MFJ precedent. To accept Applicants' argument would unlawfully be "[t]o permit the true nature of [the] transaction to be disguised by mere formalisms." *Commissioner of Internal Revenue* v. *Court Holding Co.*, 324 U.S. 331, 334 (1945).

Applicants' argument is contrary to the text of Section 3(1). Applicants' claim (p. 38) that Section 3(1) only permits consideration of what they call "current equity" and not "future interests" (even those "future interests" that have marketplace value today) cannot be squared with that provision's plain language or obvious purpose. Section 3(1) was carefully drafted so as to preclude reliance on precisely such artificial formalisms, and to require a focus on economic realities. First, Section 3(1) does not just prohibit Bell Atlantic from "directly . . .own[ing]"

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embedded yet another "option" in the Class B shares – an option that can be quite valuable. For example, if Bell Atlantic believed that value of DataCo's share would decline over time, it could sell some its Class B shares then subsequently exercise its "option" to reacquire those shares at a lower price. Likewise, this provision would mean that even if Bell Atlantic allowed DataCo to issue stock options to its employees, Bell Atlantic could subsequently dilute the value of those shares by obtaining from DataCo sufficient shares to give it 80 percent of DataCo's shares.

DataCo, but also from "indirectly" owning DataCo. Second, the term "owns" is defined to mean an "equity interest (*or equivalent thereof*)" of more than 10 percent (emphasis added). Thus, the statute expressly precludes an approach under which the analysis stops simply because Bell Atlantic will own only 10 percent of the voting stock. "Future" interests such as the conversion rights at issue here – which represent 80 percent of DataCo's value – must be taken into account in determining whether Bell Atlantic "owns" DataCo both because they constitute "indirect" ownership and because they can be "equivalent" to equity ownership.[6]

Applicants' argument is inconsistent with Commission precedent. Contrary to Applicants' claims, the Commission has repeatedly made clear that companies cannot use instruments such as options, warrants and convertible debentures to avoid statutory ownership restrictions analogous to Section 3(1). For example, Section 652(a) of the Act – which Bell Atlantic concedes (p. 39) has a purpose analogous to that of Section 271 – provides that "[n]o local exchange carrier or any affiliate of such carrier owned by, operated by, controlled by, or under common control with such carrier may purchase or otherwise acquire directly or indirectly more than a 10 percent financial interest, or any management interest, in any cable operator providing cable services within the local exchange carrier's telephone service area." 47 U.S.C. § 572(a). In implementing that provision, the Commission expressly rejected the notion advanced by Applicants here that such "options, warrants, and convertible debentures" could never constitute a "financial interest" in a company. Rather, the Commission determined that even these

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[6] Applicants' citation (p. 36) to *Paulsen v. IRS*, *supra*, in support of their contention that the Commission can consider only "current" and not "future" equity stands that decision on its head. In that case, the Court found that a financial instrument, despite being labeled as "equity" was, "[i]n reality," predominantly debt. 469 U.S. at 138-39. In rejecting the attempt by the taxpayers

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nonvoting interests could provide the ability "for certain substantial investors or creditors to exert significant influence over key decisions" and, indeed, that such influence could be even greater than that exercised by "voting equity holders." Report and Order, *In re Implementation of 1992 Cable Act*, CS Docket No. 98-82, ¶ 83 (1999) ("*Cable Attribution Order*").[7]

The Commission's rules reflect that finding. Thus, in 47 C.F.R. § 76.501, Note 2(e), they provide that "*[s]ubject to paragraph (i) of this Note*, holders of debt and instruments such as warrants, convertible debentures, options or other non-voting interests with rights of conversion to voting interests shall not be attributed unless and until conversion is effected." (Emphasis added). Subparagraph (i), in turn, provides that any such interest *will* be attributed where that interest (or combination of interests) "exceed[s] 33 percent of the total asset value . . . of that entity." 47 C.F.R. § 76.501, Note 2(i). And as explained above, the Class B shares Bell Atlantic would be acquiring represent at least 80 percent of the total value of DataCo.

The Commission likewise determined that economic reality, not labels, mattered when implementing Section 623(l) of the Act, 47 U.S.C. § 543, which gives a cable operator that faces competition from a "local exchange carrier or its affiliate" relief from certain rate regulations. Applicants can contend otherwise only by omitting the critical language when they quote the Commission's Order. Thus, Applicants quote the Commission as stating that "[w]e do not believe that these types of securities [options, warrants, and convertible debentures] demonstrate . . .

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to evade the tax laws by use of corporate formalisms, the Court made clear that it would not "exalt artifice over reality." *Id.* at 141.

[7] AT&T has petitioned for review of the Commission's *Cable Attribution Order* on the ground that several of the attribution rules contained in that order are arbitrary and contrary to the Act. However, if the principles underlying the attribution rules contained in that order are to be applied consistently, they must be applied to Applicants' proposed transaction.

current active participation." Supp. Filing at 37. The full sentence of the Order, by contrast, states: "We do not believe that these types of securities demonstrate the type of current, active participation by a LEC envisioned by the LEC test, *unless the amount of these securities that an investor holds is more than 33% of the total assets of a company.*" *Cable Attribution Order* ¶ 129 n.329 (1999) (emphasis added). *See also* 47 C.F.R. § 76.905(i).

In this regard, Applicants badly misrepresent their lead case, Memorandum Opinion and Order, *In the Matter of Time Warner Cable*, 12 FCC Rcd. 23363 (CCB 1997) ("*Time Warner Cable*"). First, contrary to Applicants' claims (at 38), this is not a "Commission precedent applying Section 3(1)." *Time Warner Cable* is a decision by the *Cable Bureau* applying *Section 623* of the Communications Act. 12 FCC Rcd. ¶ 3. Second, the Cable Bureau's decision preceded the Commission's subsequent determination in the *Cable Attribution Order* that "options, warrants, and convertible debentures" could establish "affiliat[ion]" within the meaning of Section 623. *Cable Attribution Order* ¶ 129 n.329. Finally, the Cable Bureau did not, as Applicants claim, hold that future interests "do not count as equity interests unless and until conversion is effected." Supp. Filing at 38-39 (citing *Time Warner Cable* ¶ 8). The paragraph cited by Applicants was simply a summary of the views previously expressed by *Bell Atlantic* in a related proceeding. By contrast, the Cable Bureau expressly rejected that notion, finding that Commission precedent establishes that "it is necessary to examine the economic realities of the transaction under review and not simply the labels attached by the parties." *Time Warner Cable* ¶ 19 n.49.[8]

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[8] Ultimately, the Cable Bureau concluded that there was no affiliation because the BOCs "were no longer interested in continuing their business relationship" with the entity in question and were undertaking to find a purchaser for that interest. *Id.* ¶ 20.

Applicants likewise squarely miscite the broadcast attribution rules. They note that a footnote at the beginning of the Commission's recent order on those rules states that "nonvoting instruments such as options or warrants" and "debt" are not "currently attributable." Supp. Filing at 37 (citing Report and Order, *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, 14 FCC Rcd. 12559, ¶ 2 n.4 (1999) ("*Broadcast Attribution Order*")). They fail to note, however, that the *Broadcast Attribution Order* was issued to "review" and "amend" those (and the other) then-existing broadcast attribution rules. *Id.* ¶¶ 1-2, 35-65. And in doing so, the Commission relied on the same principle that it employed in the *Cable Attribution Order* – *i.e.*, that, regardless of label, any interest or combination of interests that in aggregate exceeds 33 percent of the value of the company can be considered attributable. *See generally Broadcast Attribution Order* (adopting 47 C.F.R. § 21.912, Note 1(j) (cable/MDS cross-ownership rule); *id.* § 73.3555, Note 2(j) (broadcast multiple-ownership rule); *id.* § 76.501 Note 6(c) (broadcast/cable cross-ownership rule); *Cable Attribution Order* ¶¶ 102-06 (discussing and applying *Broadcast Attribution Order*).[9]

Contrary to Applicants' assertions (pp. 41-42), the Commission's foreign ownership limits cases again show that the Commission is concerned with economic reality, not corporate fictions. For example, in *In re Application of Fox Television Stations, Inc.*, 10 FCC Rcd. 8452 (1995) ("*Fox*"), the Commission addressed the issue of whether a foreign investor that paid-in more than 99 percent of the capital of a company for common stock representing only 24 percent of the

[9] *In re Richard Zaragoza*, 14 FCC Rcd. 1732 (1998), also cited by Applicants (p. 39), is inapposite, for it applied the old attribution rules that were superseded by the *Broadcast Attribution Order*. Furthermore, in determining that the option in that case should not be attributable, the Mass Media Bureau noted that the option at issue "may not be exercised." *Id.* ¶ 20. Here, by contrast, it is clear that the option will be exercised. *See supra* pp. 7-9.

voting power violated the 25 percent ownership limit established by Section 310(b)(4).[10] The Commission concluded that "[w]here the ownership of corporate shares does not correspond to the beneficial ownership of the corporation, we will not be bound by a formalistic and formulaic 'count-the-shares' approach that understates the true extent of ownership." *Id.* ¶ 48. This is particularly true where the corporation issues "more than one class of stock, and those classes have widely divergent characteristics." *Id.* ¶ 36. Thus, while the Commission in its foreign ownership limits cases will not look at "*bona fide*" future and debt interests in determining ownership, such interests are not considered "*bona fide*" where, as here, the "ownership of corporate shares does not correspond to the capital contributed to the corporation." Memorandum Op. and Order, *In re Application of NextWave Personal Communications, Inc. for Various C-Block Broadband PCS Licenses*, 12 FCC Rcd. ¶¶ 36, 46 (WTB 1997). In those instances, the Commission will determine foreign ownership interests on the basis of "stock ownership *and* capital contributions." *Id.* ¶ 36 (emphasis added). *See Fox* ¶ 50 (finding company that contributed 99 percent of capital but only receiving 24 percent of shares to have an ownership interest well in excess of 25 percent).[11]

The remaining Commission precedents cited by Applicants are simply irrelevant to construing Section 3(1). For example, the LEC/LMDS cross-ownership provisions were adopted pursuant to Section 309(j), which does not itself prohibit LEC ownership or control of any LMDS

[10] Section 310(b)(4) of the Act precludes ownership of a broadcast or common carrier route by "any corporation directly or indirectly controlled by any other corporation of which more than one-fourth of the capital stock is owned of record or voted by aliens . . . ." 47 U.S.C. § 310(b)(4).

[11] Applicants reliance on Section 310(b)(4) is also inapposite because it is much less broad than Section 3(1). Unlike Section 3(1)'s far reaching language, Section 310(b) specifically limits the "ownership" inquiry to whether "the *capital stock* is owned *of record* or voted by aliens."

license. Rather, it directs the Commission to establish eligibility criteria to "promot[e] economic opportunity and competition . . . by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants." 47 U.S.C. § 309(j). Based on these different policies, the Commission adopted attribution rules that were much more relaxed than in other contexts. For example, the Commission determined that a LEC may own up to a 20 percent interest in a company that holds an LMDS license because the statute required it to consider "encouraging capital investment and business opportunities in LMDS" and "increased flexibility in our rules [in order to enable] LMDS providers to adapt their services to meet customer demand."[12]

The CMRS spectrum aggregation limits cited by Applicants (at 37-38) were promulgated pursuant to Section 322 of the Communications Act, which generally authorizes the Commission to manage spectrum consistent with a number of factors such as the need to "improve the efficiency of spectrum use and reduce regulatory burden on spectrum use."[13] That the Commission may have struck a balance that allowed for increased concentration of spectrum ownership casts no light on the proper interpretation of "indirect ownership" and the "equivalent of equity" for purposes of Section 3(1) and Section 271. *See also* Report and Order, *In the*

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[12] See Second Report and Order, *Order on Recon, and Fifth Notice of Proposed Rulemaking, In the Matter of Rulemaking to Amend Parts 1, 2, 21, and 25 of the Commission's Rules*, 12 FCC Rcd. 12545, ¶ 190 (1997).

[13] More precisely, "in taking actions to manage the spectrum," the Commission is to determine "whether such actions will (1) promote the safety of life and property; (2) improve the efficiency of spectrum use and reduce the regulatory burden upon spectrum users based upon sound engineering principles, user operational requirements, and marketplace demands; (3) encourage competition and provide services to the largest feasible number of users; or (4) increase interservice sharing opportunities between private mobile services and other services." 47 U.S.C. § 332.

Matter of 1998 Biennial Regulatory Review Spectrum Aggregation Limits for Wireless Telecommunications Carriers, WT Docket 98-205, ¶ 95 (1999) (noting that CMRS attribution standards much more generous than other "benchmarks used by the Commission in other contexts" because of the "Commission's policy in the early days of the cellular industry to encourage the formation of settlement groups"). Notably, however, the Commission determined that options and warrants are always attributable in the context of auctions to acquire spectrum. *See* 47 C.F.R. §§ 1.2110(b)(2), 22.223(d)(5), 24.709(a), 95.816, 101.1112, 101.1209.

Applicants' proposed transaction would have been illegal under the MFJ. Applicants similarly misrepresent the MFJ precedent that they cite.[14] While the MFJ court did allow NYNEX to purchase a conditional interest in a concern that would provide interexchange services in the future (*see United States v. Western Elec. Co.*, Civ. Action No. 82-192, slip op. (D.D.C. Aug. 7, 1986) ("*Tel-Optik Case*")), Applicants are flatly wrong in suggesting (pp. 40-41) that the court held that options or other conditional interests could never create affiliation.[15] To the contrary, the MFJ court expressly rejected this argument. *Tel-Optik Case*, slip op. at 3-4. *See also United States v. Western Elec. Co.*, Civ. Action No. 82-192, slip op. at 3-4 (D.D.C. Jan. 31, 1992) (this Court has "rejected the . . . argument that no waiver or Department approval [is] required prior to a Regional Company acquiring a conditional interest in a prohibited line of business"). Rather, the Court opined that "manipulations of form should not obscure the real economic incentives

[14] To assist the Commission, AT&T has attached at Tab A the unreported MFJ authorities cited by Applicants and discussed herein.

[15] Similar to the Act, the MFJ prohibited a BOC "directly or through an affiliated enterprise" from providing "interexchange telecommunications services." *United States v. Western Elec. Co.*, 552 F. Supp. 131, 227 (D.D.C. 1982) (MFJ § II(D)). Unlike the Act, however, the MFJ did not define "affiliate."

underlying . . . [a particular business] relationship." *Tel-Optik Case*, slip. op. at 3 (citation omitted).

Accordingly, the MFJ court determined that a BOC's purchase of a conditional interest in a company providing interexchange services would constitute a "real economic interest" unless the BOC could demonstrate that: (1) the investment in the conditional interest was minor; (2) the exercise of the conditional interest was genuinely in doubt; and (3) the interest would give the BOC no ability or incentive to discriminate. *Tel-Optik*, slip op. at 5-7.

The interest that Bell Atlantic would acquire in DataCo flunks all three requirements. The investment here is patently not minor. In exchange for the Class B shares, Bell Atlantic-GTE will contribute *all* of GTE's existing data business – including GTE's 17,000 mile Internet backbone network which was built at a cost of over $1.3 billion and which generates over $780 million in annual revenues.[16] By contrast, the type of contingent interest found "minor" in *Tel-Optik* was a $10 million investment. *Tel-Optik Case*, slip op. at 6. Likewise, there can be no doubt that the conditional interest will be exercised. *See supra* pp. 7-9.[17] Finally, as discussed *infra* in Part III, owning the Class B shares will give Bell Atlantic the incentive and ability to discriminate to favor DataCo.[18]

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[16] http://www.bbn.com/announcements/news/press_release_19991213-01.xml; GTE 1998 Annual Report at 13.

[17] In contrast to the situation here, where there is no cost to Bell Atlantic of exercising the contingency it would acquire, exercise of the contingency in *Tel-Optik* depended upon successful construction and deployment of a fiber optic cable and would have required an expenditure of $150-$200 million dollars. *See* Report of United States to the Court Concerning Proposed Purchase by NYNEX Corp. of Conditional Interest in Tel-Optik Ltd., Civil Action No. 82-192, at 5-6 (June 20, 1986) ("DOJ Tel-Optik Report").

[18] The Department of Justice Reports cited by Applicants (at 43-46) likewise provide no support for their proposed transaction. As an initial matter, while Applicants assert (at 44-46) that the

(continued . . .)

II. BELL ATLANTIC WOULD CONTROL DATACO IN VIOLATION OF SECTION 271

Applicants' proposal also violates Section 271 on the independent ground that DataCo – which will be created by, significantly intermingled with, and ultimately re-acquired by Applicants – will be "directly or indirectly . . . control[led]" by Bell Atlantic. The term "control," though not further defined in the Act, appears throughout it and in numerous Commission rules.[19] Especially

(. . . continued)
MFJ court approved the conditional interests at issue in these reports, that is simply not true. The district court never acted on challenges to those Reports.

In all events, even a cursory examination of the Department's Reports reveal that, unlike the conditional interest that would be acquired by Bell Atlantic here, the conditional interests found acceptable by the Department easily satisfied the three *Tel-Optik* standards. For example, the investment necessary to acquire the contingent interests in these cases ranged from $1.5 million to $15 million – a tiny fraction of Bell Atlantic-GTE's investment here. *See* Letter from Liam Coonan to Barry Grossman, at 3 (Apr. 6, 1988) ("Coonan Letter"), attached to Report of the United States Concerning the Proposed Retention of a Conditional Interest by Southwestern Bell Corp., Civ. Action No. 82-192 (D.D.C. Apr. 15, 1988) ("SBC Report") ($1.5 million investment); Letter from Thomas Hester to Nancy Garrison, at 4 (July 7, 1987) ("Hester Letter"), attached to Report of the United States to the Court Concerning Ameritech's Acquisition of a Conditional Interest, Civ. Action No. 82-192 (D.D.C. July 15, 1987) (up to $15 million investment). Likewise, in each of these cases, there was a genuine question as to whether the contingency would be exercised. For example, the SBC contingency could only be exercised if SBC were able to convince the MFJ court that ownership of a company that engaged in research, development and sale of customer premises equipment was lawful under the decree. *See* Coonan Letter at 1-2. Finally, because each transaction involved the purchase of only a small, minority interest in companies, the BOCs' incentives to discriminate were attenuated. *See* SBC Report at 1 n.1 (contingency would allow acquisition of 12 to 17 percent interest); Letter from Kenneth Millard to Barry Grossman, at 5 (Sep. 16, 1986), attached to Report of the United States to the Court Concerning Procedures for Approval of Conditional Interests and Ameritech's Acquisition of a Conditional Interest in Corporation X, Civ. Action No. 82-192 (D.D.C. Sep. 19, 1986) (contingency would allow acquisition of five to eight percent interest); Hester Letter at 4 (contingency would allow acquisition of 15 percent interest).

[19] *E.g.*, 47 U.S.C. §§ 152(b), 310(d); *cf. id.* §§ 310(b)(4), 522(2), 572(b); *see also, e.g.*, 47 C.F.R. §§ 1.2110(b)(4)(ii), 27.210(d), 101.1112(h)(2), 76.501, nn.1-2; 73.3555 nn.1-2. At least as to Section 10(d), Congress deliberately omitted a more detailed definition of "control" from the Act because it was did not wish to "limi[t] the meaning of the term in an unfortunate manner." H.R. Rep. No. 1850, 73d Cong., 2d Sess. 4-5 (1934).

where those provisions share with section 271 the asserted purpose of preventing anticompetitive or discriminatory conduct, they (and decisions applying them) are pertinent authorities for interpreting section 3(1).[20] And those provisions and decisions clearly establish that Bell Atlantic would "control" DataCo.

Applicants' contrary claim rests exclusively on what they call the "most importan[t]" fact: that public shareholders of DataCo would hold "90% of the voting control." Supp. Filing at 44. But the courts and the Commission have squarely rejected that view and have determined that "the search for control necessarily calls for an investigation *beyond* stock ownership to determine *effectively* where actual control resides." *In re Application of Stereo Broadcasters, Inc.*, 55 F.C.C.2d 819, ¶ 7 (1975) (emphasis added); *see also, e.g., Cleveland Television Corp.* v. *FCC*, 732 F.2d 962, 967 (D.C. Cir. 1984) (control "encompasses various forms of working control . . . , whether or not such control is manifested by a majority share of voting stock"). It has long been established that "Congress did not imply artificial tests of control" (*Rochester Tel. Corp.* v. *U.S.*, 307 U.S. 125, 145 (1939)), and that "passage of control need not be legal control in a formal sense, but may consist of actual control" (*Lorain Journal Co.* v. *FCC*, 351 F.2d 824, 829 (D.C. Cir. 1965) (citation omitted)).[21]

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[20] Indeed, when applied to the Section 271 context, the Commission's rules and prior decisions regarding control should be strengthened because the risks associated with anticompetitive conduct – as well as the history of evidence of such conduct – are far greater in the interLATA context than elsewhere.

[21] *See also, e.g.*, 47 C.F.R. § 73.3555, note 1 ("The word 'control' as used herein is not limited to majority stock ownership, but includes actual working control *in whatever manner* exercised") (emphasis added); *Kaiser Foundation Health Plan* v. *Clary & Moore*, 123 F.3d 201, 206 (4th Cir. 1997) (refusing to "allow a corporation which, by all indications is under the same control as its predecessor," to avoid the consequences of that control "by manipulating superficial indicia of ownership").

Thus, the Commission's regulations on affiliation and control in the competitive bidding process state that "[c]ontrol may be affirmative or negative and it is immaterial whether it is exercised so long as the power to control exists." 47 C.F.R. § 1.2110(b)(4)(ii)(A). Those rules also provide that control can arise through a wide variety of means, including "stock ownership; occupancy of director, officer or key employee positions; contractual or other business relations; or combinations of these and other factors" (*id.* § 1.2110(b)(4)(ii)(B)) – all of which are present in Bell Atlantic's proposed relationship with DataCo.

As discussed below, the Commission has found that minority shareholders – even those holding just 5 or 10 percent of the voting rights – can, through the use of other devices, influence or control a company, particularly one that has a dispersed ownership, as Applicants have made certain that DataCo will. *See infra* pp. 26-27 (describing provision ensuring that no entity, other than Bell Atlantic, holds 10 percent or more of DataCo).[22] Beyond the provisions that would allow the public limited voting rights in DataCo, Applicants can point to virtually nothing else in the proposed structure to support its claim that Bell Atlantic would not control DataCo.[23] Instead, in the remainder of this portion of their submission, Applicants attempt merely to defend other aspects of the proposal that were designed to ensure that Bell Atlantic will have substantial

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[22] AT&T is appealing the Commission's *Cable Attribution Order inter alia* to the extent that it establishes that a 5 percent interest standing alone generally will be considered sufficient to establish control that is relevant to any legitimate competitive concern.

[23] In a single paragraph, Applicants claim to examine "[o]ther relevant factors in the *de facto* control analysis," but in fact their analysis is nothing more than a truncated recitation of certain factors the Commission sometimes considers, and an *ipsi dixit* conclusion that the "investing public . . . will control DataCo." *See* Supp. Filing at 45. Those assertions are palpably insufficient to demonstrate an absence of control, particularly where, as here, the putatively independent company has not yet been formed and there is no actual record of corporate management to examine. *See, e.g.*, *Baker Creek*, 13 FCC Rcd. 18709, ¶ 8; *LaStar Cellular Tel. Co.*, 9 FCC Rcd. 7108, ¶¶ 17-18 (1994).

power over a wide array of DataCo's corporate affairs. Although Applicants claim that the Commission has routinely approved individual such provisions without finding control, that is not dispositive here because, as Applicants admit (at 44), control turns on multiple factors. No single factor, standing alone, dictates a finding of control, and therefore when determining control the Commission "must assess the cumulative effect of all relevant factors." *BBC License Subsidiary*, 10 FCC Rcd. 7926, ¶ 42 (1995). Thus, rather than examine Bell Atlantic's rights in isolation (as Applicants have done), the Commission must consider them together with other "relevant facts and circumstances." *Baker Creek Communications*, 13 FCC Rcd. 18709, ¶ 7 (1998). Here, significant provisions of DataCo's structure provide Bell Atlantic with an unprecedented collection of rights – and the power to control DataCo.

First, Applicants have provided themselves with so-called "Investor Protections Mechanisms" that would allow them to block significant – and even standard – corporate activity by DataCo. Applicants assert that such protections are "routine," but that is not so. Many of the provisions are not in the slightest "routine" for a minority investor holding 10 percent of voting rights, and would provide Bell Atlantic with a substantial ability to control DataCo's day-to-day operations. For example, Bell Atlantic is permitted to veto any "agreements or arrangements" that "materially adversely affect DataCo's results of operation or financial condition." Supp. Filing, Sched. A. Because whether Bell Atlantic's consent is required ultimately requires a guess as to the future impact of an agreement, any prudent manager would routinely request Bell Atlantic's consent for virtually any significant arrangement. The effect of this "investor safeguard" would therefore provide Bell Atlantic with the right to review all significant agreements contemplated by DataCo – again, precisely the type of day-to-day intrusion into DataCo's affairs that will subject it to Bell Atlantic's control. *See, e.g.*, 47 C.F.R.

§ 1.2110(b)(4)(ix). Such safeguards may be appropriate in certain business transactions – such as mergers or joint ventures – but they are not the norm for investors that are obtaining a ten percent voting interest.

Applicants claim that the Commission has approved such provisions, but the two cases they cite – *Roy Speer* and *Quincy Jones*[24] – presented entirely different situations. Most notably, in both cases, the Commission found that the minority shareholder's ability to exert control was mitigated – unlike here – by an identifiable and independent person or group of persons that would also invest in and manage the entity. *Roy Speer* ¶ 26; *Quincy Jones* ¶ 24. Moreover, none of the rights at issue in *Roy Speer* or in *Quincy Jones* granted the minority shareholder the ability to review all the "agreements or arrangements" that could materially affect the entity's financial condition, as is the case here.[25]

Second, DataCo would begin operations with employees of GTE in key management and employee positions, and because Bell Atlantic will re-acquire DataCo, those employees will have overwhelming incentives to operate DataCo pursuant to Bell Atlantic's interest. For example, Paul Gudonis, the current president of GTE Internetworking, will continue in that position and will become CEO and Joseph C. Farina, president and CEO of Bell Atlantic's Data Solutions Group, who will be executive vice president and COO of DataCo. Bell Atlantic News Release, *Bell Atlantic and GTE Designate Senior Executives for Merged Company* (Jan. 28, 2000). Each

[24] *In re Application of Roy H. Speer, Transferor, and Silver Management Co., Transferee*, 11 FCC Rcd 14147 (1996) ("*Roy Speer*"); *Application of Quincy D. Jones, Transferor, and Qwest Broadcasting, LLC, Transferee*, 11 FCC Rcd 2481 (1995) ("*Quincy Jones*").

[25] In *Roy Speer*, the separate statements by Commissioners Barrett and Ness both emphasized that it was "very pertinent" that the *de jure* owner in fact was independent of the minority investor and planned to manage the entity using his significant experience.

of those employees' long-term personal and professional interests will most securely be advanced by assuring that Bell Atlantic and DataCo are, taken together, as valuable as they can be. Indeed, the "investor safeguards" further cement those incentives by precluding DataCo from offering (without consent from Bell Atlantic) its managers and employees "payments" or "other rights" that would be triggered by Bell Atlantic re-acquisition of DataCo. Supp. Filing, Sched. A. These so-called "golden parachutes" might mitigate those employees' incentives to favor Bell Atlantic's interests because they would know that such payments would be available when Bell Atlantic re-acquires DataCo. The fact that DataCo's managers and employees will necessarily be seeking to further Bell Atlantic's interest further strengthens Bell Atlantic's control.[26]

Third, Bell Atlantic would retain an equity interest of 10 percent with full voting rights in DataCo. In its recent attribution orders, the Commission stated that it "remain[ed] convinced" that even "shareholders with ownership interests of 5 percent or greater may well be able to exert significant influence on the management and operations of the firms in which they invest." *Broadcast Attribution Order* ¶ 10; *Cable Attribution Order* ¶ 45 (a voting share benchmark of 5 percent "permit[s] a significant potential for influence or control").[27]

Fourth, the "investor safeguards" guarantee Bell Atlantic at least one seat on the Board, Supp. Filing, Sched. A, which, the Commission has found, can be a significant indicator of

[26] Presumably, even after DataCo is formed, these GTE employees will retain their currently vested pension plans right, benefit plans, and any GTE stock options they hold – all services that the merged entity would be authorized to provide directly to Data Co, *see* Supp. Filing, Sched. B – which is further evidence that Bell Atlantic and DataCo will remain impermissibly entangled and that DataCo's personnel will have strong incentives to act pursuant to Bell Atlantic/GTE's perceived wishes.

[27] As noted, AT&T has appealed that Order, but if the Commission has determined that it will apply to cable operators a five percent voting interest as a benchmark for control, then the case for control under the circumstances in Applicants' proposal is even stronger.

control. In its recent *Cable Attribution Order* (¶ 68), the Commission recognized that it may be appropriate to allow the same director to serve on multiple boards in order to effectuate public policies, but only if adequate safeguards are in place regarding the selection and duties of such a director. But Applicants do not propose any safeguards to insulate their hand-picked director from decisions that implicate the competitive concerns underlying Section 271.[28] Further, Applicants' proposal provides no details regarding the mechanism for the initial selection of the supposedly independent members of DataCo's board of directors (or of its key officers and managers) and it appears likely that Applicants will in fact control that process. Thus, Applicants may very well control the entire board of directors of DataCo.

Fifth, Applicants have ensured that Bell Atlantic's 10 percent interest would make it the largest single shareholder in DataCo and that Bell Atlantic would thereby control the largest voting block. Specifically, Applicants have designed the publicly held Class A shares so that they "initially contain a provision that . . . prevents any single holder or group (as defined under SEC rules) from voting more than 10% of the Class A stock." Supp. Filing, Sched. A. This term is not merely an anti-takeover device that would prevent any other person from acquiring *de jure* control of DataCo. More fundamentally, that provision – which is nowhere even discussed by Applicants in their 54-page supplemental filing – ensures that no other single entity will ever hold more voting power in DataCo than Bell Atlantic. *See* 47 C.F.R. § 1.2110(b)(4)(iv)(B) (under rules for competing license applications, "[a]n applicant is presumed to control or have the power to control a concern even though he or she owns, controls or has the power to control less than

[28] Indeed, when SBC, under the MFJ, was required to divest itself of ownership and control of a prohibited interest in a customer premises equipment firm, it responded by, *inter alia*, foregoing its seat on the firm's board of directors. *See* Coonan Letter at 2.

50 percent of the concern's voting stock, *if the block of stock he or she owns, controls or has the power to control is large as compared with any other outstanding block of stock*); *id.* § 101.1112(h)(4)(ii) (same).

Finally, Applicants cite (pp. 48-49) the sharing of network facilities between AT&T and the BOCs that occurred after divestiture as supporting their day-to-day involvement in DataCo's activities. The divestiture of the BOCs, however, was patently and fundamentally different from the proposal here. Most significantly – and in stark contrast to this proposal – the MFJ sharing provisions were employed as a prelude to more complete divestiture, not as a springboard to further re-integration. Thus, AT&T was strictly prohibited after divestiture from holding voting rights or any other type of "stock or assets" of a BOC, had no representation on a BOC's board of directors, and also was expressly prohibited from re-acquiring a BOC. *See United States* v. *AT&T*, 552 F. Supp. 131, 227 (D.D.C. 1982) (MFJ § I(D) provided that "AT&T shall not acquire the stock or assets of any BOC"). The MFJ provisions that permitted limited sharing of facilities expressly provided that the "BOC [wa]s ensured control" of the relevant portion of the facilities at issue. *Id.* (MFJ § I(A)(2)).[29] The MFJ, therefore, in no way supports Applicants' claim that the proposed commercial contracts with DataCo, in combination with the numerous other rights Bell Atlantic would have, do not grant Bell Atlantic a mechanism for control; to the contrary, the MFJ establishes that the most effective remedy is a complete divestiture of GTE's interLATA facilities.

[29] Thus, the shared facilities in the MFJ essentially required leasing of certain functions of the network, making them more akin to the requirement in section 251(c)(3) of the Act that requires the BOCs to provide unbundled access to certain network elements. Moreover, the sharing permitted by the MFJ lasted for a limited duration, and the rates paid for any such services were strictly cost-based.

III. THE TRANSACTION IS CONTRARY TO THE PURPOSES OF SECTION 271

As described above, the Applicants' proposal is unlawful because Bell Atlantic will have ownership and control of DataCo. Moreover, and contrary to the Applicants' argument, the proposal would also violate the purposes of Section 271 – preventing monopoly leveraging and discrimination in the interLATA market and creating incentives for BOCs to open their local markets to competition. *See AT&T Corp. v. Ameritech Corp.*, 13 FCC Rcd. 21438 (Oct. 7, 1998) (Sept. 28, 1998) ("*Qwest Order*"), *aff'd sub nom., U S WEST Communications, Inc. v. FCC*, 177 F.3d 1057 (D.C. Cir. 1999). As was the case with respect to the unlawful arrangements the Commission addressed in the *Qwest Order*, the Applicants here would be "pre-positioning" interLATA Internet customers so as to enjoy a significant jumpstart when Bell Atlantic obtains the necessary Section 271 authorizations. For this reason, Bell Atlantic would have the incentive – and because of its control of the local bottleneck, the ability – to discriminate in favor of DataCo.

First, the transaction gives Bell Atlantic obvious incentives to discriminate in favor of DataCo. Applicants assert in their Public Interest Statement that GTE's Internet business (and hence, DataCo) can only succeed (and perhaps remain viable) if it has access to the urban, high-density, business-rich customer bases in Bell Atlantic cities such as Boston, Newark, Philadelphia, Wilmington, Baltimore, metropolitan Washington, D.C. and Richmond. According to Applicants, the marketing and distribution channels that only Bell Atlantic can provide would enhance the volume of data and Internet traffic over the backbone and the number of valuable Web sites and customers connected to the backbone. BA-GTE Public Interest Statement at 3, 16.

But GTE already has "access" to customers in all these regions because its backbone network extends into these cities. And given that GTE is the number four backbone provider and that its business generates over $700 million in revenues a year, it is obviously not on the verge of failure. Thus, Applicants can only mean that GTE will benefit enormously from the fact that Bell Atlantic will be able to use its dominant status and control of bottleneck facilities in these markets to ensure that existing Bell Atlantic customers that need access to the Internet do so using GTE's facilities.

Consequently, the only question is whether this incentive will exist prior to the time Bell Atlantic exercises its "option." It will. Because there is no price for exercising the option, and because Class A shareholders will not capture profits earned by DataCo, Bell Atlantic will capture all benefits from discrimination when it exercises its conversion rights.

Applicants' response (p. 53) – that Bell Atlantic will lack any incentive to discriminate because such discrimination would make it more difficult for it to obtain Section 271 relief and then to exercise its option – is meritless. Applicants have structured the transaction to create a no-lose situation. Even if the competitors could successfully prove such discrimination and convince the Commission to deny Bell Atlantic Section 271 authority on that ground, Bell Atlantic would simply sell its Class B shares to an entity not bound by Section 271. Thus it would, even under that scenario, capture the full benefits of its unlawful discrimination in the sale price.[30]

Second, Bell Atlantic plainly has the ability to discriminate, which derives from its continued control of bottleneck local exchange facilities. Applicants cannot suggest that they lack the ability to steer Bell Atlantic's existing local exchange customers onto GTE's Internet

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[30] This further distinguishes this situation from the facts in *Tel-Optik*. *See supra* p. 18-19. Moreover, in *Tel-Optik* there could be no discrimination because the interexchange facilities in (continued . . .)

facilities when, as discussed above, they promote that ability as the *raison d'être* of the merger. For example, while Bell Atlantic cannot (consistent with Section 271) provide any Internet backbone transport (or links to such transport) to the customers of its Internet access service and instead must rely on a third party to provide this transport for its customers,[31] Bell Atlantic would have the ability to influence its ISP customers to chose DataCo when they sign up for service.

Likewise, Bell Atlantic can discriminate in favor of DataCo on the ISP/Internet backbone provider ("IBP") link to make sure that DataCo's backbone will get higher "throughput" than DataCo's competitors. More specifically, when an ISP resells Bell Atlantic's DSL service, part of the service that they must purchase from Bell Atlantic is transport from the DSLAM in the central office to their Internet backbone provider. That transport is generally provided over an Asynchronous Transfer Mode Permanent Virtual Circuit ("PVC") and Bell Atlantic can control the throughput on that PVC. More specifically, Bell Atlantic can give priority to certain PVC users – thereby ensuring that their traffic will be prioritized over the traffic of disfavored customers. Bell Atlantic today makes no contractual representations in its tariff as to what PVC speed a DSL reseller will get and there is no way for the DSL reseller to directly compare the PVC throughput it receives with its competitors to determine whether they are getting better PVC service than it is. In short, Bell Atlantic can discriminate in favor of DataCo by ensuring that ISPs

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(. . . continued)
question had not even been built at the time the option was acquired. DOJ Tel-Optik Report at 5-6.

[31] Order, *In the Matter of Bell Atlantic Tel. Cos.*, 11 FCC Rcd. 6919 (CCB 1996).

that use DataCo obtain superior Internet access connections to those that do not. This in turn would create a powerful incentive for ISPs to chose DataCo as their backbone provider.[32]

Finally, denying the requested relief will create the strongest incentives for Section 271 compliance. Applicants claim that the need for Bell Atlantic to obtain Section 271 relief or lose the GTE-I interLATA backbone network will motivate it to open local markets. Supp. Filing at 50, 52. But Bell Atlantic will be even more motivated to open its local market if it has to do so before it would be permitted simultaneously to merge and obtain ownership and control of GTE's interLATA Internet business.

[32] Applicants' claims that they cannot discriminate are particularly ironic in light of the substantial evidence in this proceeding that Bell Atlantic already discriminates in related contexts. In its Comments on this merger, MCI WorldCom demonstrated that Bell Atlantic was already seeking "to leverage its local bottleneck power in order to increase their Internet business" by, for example, "blatantly steering" its residential customers to its own ISP. Comments of MCI WorldCom at 39-52 (Nov. 23, 1998).

CONCLUSION

For the reasons stated above, the Commission should hold that Applicants' proposed transaction does not comply with Section 271 of the Act.

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